

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE ATTORNEY GENERAL



ATTORNEY GENERAL

MEMORANDUM

TO: Robert C. Bobb
City Administrator

FROM: Robert J. Spagnoletti
Attorney General

DATE: August 4, 2005

SUBJECT: GHMSI's charitable obligation -- remaining issues after May 15, 2005
report of Department of Insurance, Securities, and Banking

This memorandum responds to your request for a summary of the remaining issues with respect to the "charitable obligation" of Group Hospitalization and Medical Services, Inc. ("GHMSI"), following the issuance of the Department of Insurance, Securities, and Banking's ("DISB") May 15, 2005 report in *In the Matter of: Inquiry into the Charitable Obligations of GHMSI/CareFirst in the District of Columbia* ("DISB's report").

DISB's report correctly concludes that GHMSI has a "public health mission" and the legal authority -- but not the legal obligation -- "to engage in charitable activity beyond the provision of health insurance." In calling upon GHMSI to engage in such charitable activity, DISB cites the "social responsibility" that the company has "[a]s a major corporate citizen of the District of Columbia, and as the major health insurer in the District." DISB also concludes that GHMSI appears to be in a position to increase its financial contributions to public health initiatives without undermining "its financial strength and viability." (DISB's report at 10-11, 21)

The Office of the Attorney General ("OAG") has focused on GHMSI's legal obligations and takes no position with respect to the company's social responsibility to make charitable contributions to other organizations. OAG's conclusion is that GHMSI has a legal obligation to devote its entire operation to serving, directly or indirectly, the charitable, public health purposes for which it was chartered. It is possible for GHMSI to satisfy this obligation entirely through the provision of non-profit health insurance services that benefit present and future subscribers and, through them, the community as a whole. (Memo from Spagnoletti to Bobb, March 4, 2005) But the provision of non-

profit health insurance services is unlikely to satisfy GHMSI's obligation under its charter unless the company's bottom-line goal in providing the services is to promote public health.

Whether or not GHMSI is, in fact, operating consistently with its charitable, public health mission calls for heightened scrutiny, given the company's stated position that GHMSI's sole mission is "to operate for the benefit of its subscribers" and "not for the benefit of the public at large." ("Analysis of GHMSI's Legal Obligations under Its Federal Charter," submitted by GHMSI to DSIB, March 24, 2005) The business judgment rule gives GHMSI's board substantial discretion in determining how best to fulfill the corporation's charitable purposes. But the rule's premise is that the board recognizes and works toward those purposes. As a charitable health insurer, GHMSI's mission is to promote public health through service to its subscribers: "While the human beings who are to obtain advantages from charitable trusts may be referred to as beneficiaries, the real beneficiary is the public and the human beings involved are merely the instrumentalities from whom the benefits flow." Restatement (Third) Trusts § 28, Reporters Notes on comment *a*, quoting *In re Estate of Freshour*, 345 P.2d 689, 695 (Kan. 1959). Until GHMSI acknowledges its obligation as a "charitable and benevolent institution" to operate for the benefit of the public, one cannot presume that its corporate decisions are based on a board determination as to how best to fulfill the corporation's charitable purposes.

A determination that GHMSI is operating consistently with its chartered mission would require more than a finding that the corporation is operating non-profit, health insurance plans. It would also require a finding that GHMSI is treating the promotion of public health as its corporate mission, and treating other goals – such as generation of operating profits, enhancement of company value, accumulation of "surplus," and compensation of executives – as the *means* of advancing this mission. The relevant inquiry extends beyond what GHMSI is doing. Equally important is *why* GHMSI is doing it. Are the corporation's decisions aimed at maximizing the promotion of health or, as in the case of a for-profit insurance company, is the promotion of health merely a means toward a financial goal?

For example, the accumulation and maintenance of a surplus is essential if a charitable health insurer is to have the financial solvency necessary to fulfill its public health mission over the long term. But the insurer would be acting contrary to its charitable obligation if it made the accumulation of "surplus" an end in itself, or sought to accumulate surplus for a purpose that was not reasonably related to the company's public health mission. The stronger its current financial position and more secure its future prospects given its current surplus level, the less likely it is that the company has a *bona fide* need, consistent with its public health mission, to accumulate additional surplus. Indeed, the insurer's decision to build up asset value, at the expense of current services

that benefit subscribers and the public, may reflect an intention to abandon its public health mission in favor of a financial goal, such as maximizing asset value, that is only proper for a for-profit insurance company.

The issue of whether GHMSI is adhering to its chartered purposes can probably not be resolved without a review of internal documents – such as reports to the board of directors and minutes of board meetings – that reveal how and for what purpose the corporation has made particular decisions.

Common law has long recognized state attorneys general as the ultimate guardians of the public interest in charitable organizations. Thus, the Attorney General is the District official who would prosecute a court action to enforce a charitable corporation's charter obligations. But the Attorney General does not now have the authority, other than by filing a court action, to compel the production of documents and testimony that could reveal the intent behind the corporation's conduct. Without access to compulsory process during the investigation stage, the Attorney General may never know enough about the corporation's actual purposes so as to justify filing an enforcement action.

Because GHMSI is an insurance company as well as a non-profit corporation, the Insurance Commissioner has authority, pursuant to D.C. Code § 31-1403, to issue an "examination warrant" authorizing an examination of the corporation's books and records and an examination under oath of the corporation's employees. However, the confidentiality provision applicable to information obtained in this manner implies that the information will be used only "in the furtherance of any regulatory or legal action" by the Insurance Commissioner; it is unclear whether the information could be used in a civil enforcement action by the Attorney General. D.C. Code § 31-1404(f). One way to resolve this dilemma would be to enact legislation, recently proposed by OAG's Consumer and Trade Protection Section and reviewed by the Legal Counsel Division for legal sufficiency, that would, among other things, grant the Attorney General independent authority to subpoena documents and witnesses in the course of an investigation into whether a nonprofit corporation is acting contrary to its nonprofit purposes.